

Draft Unquantified Risks

Cost Overruns and Management Errors

While most RTOs throughout the country appear to have costs in the range of \$200 million a year—with California being higher—estimates for Grid West likely will be substantially lower than that.

The chief problem is accountability for cost overruns and management errors. With an investor-owned utilities, regulation can force those costs back on the shareholder. With a public agency, rate payer will bear those costs, but the commissioners or directors can be voted out by those who pay the bills. With Grid West, the board is not elected by the rate payers but by five customer and interest groups, some of whom may benefit from the overruns and management errors. Thus, cost overruns or management errors become a risk factor of concern.

Costs of dealing with new organization

If the California experience is any guide, the cost of dealing with the new organization is considerable. There may be some offsetting savings from not having to deal with existing institutions, and these should be measured by those looking into the financial records of existing utilities. However, Grid West is a new organization being inserted into the mix of existing organizations. As such, it contrasts with PJM, the poster child of RTOs, that has existed as an integral part of the power business in that area of the country.

Uncertainty of the Efficacy of the Planning Process

There are three risks with regard to planning: transmission centricism, allocation of the costs of facilities planned and overbuilding. First, planning is likely to be transmission-centric, because transmission planning decisions normally must be made long before substitute generation or load-interruption decisions are made. Substitutes for transmission may emerge from the market place, but market participants would plan their own substitutes for transmission on a different schedule from the transmission planners. The uncertainty of market responses tends to force planners into dealing with what they can influence directly—namely, transmission. Virtually any transmission plan can be mooted by assumptions about new generation location—distributed or otherwise—responding to market conditions—or not, if the conditions that might have caused transmission or generation needs do not arise.

Furthermore, planning for transmission is not comprehensive, because it ignores what is happening to natural-gas pipeline decisions, which can affect generation location and therefore transmission needs. Grid West only can control transmission; it does not control generation, pipeline or demand-side decisions, so it is likely to emphasize transmission solutions at the expense of better region wide solutions. (“When you have a hammer, every solution involves a nail.”)

Second, as envisioned in RTO West and Grid West documents, Grid West will have the ability to allocate costs to transmission users. A big uncertainty exists as to whether or not the transmission-centric nature of Grid West will lead to overbuilding of transmission or gold plating of its system.

Potential for Unaccounted for Costs.

Already, in the planning phases, when there is no obvious place to assign costs, the solution is to “uplift” them—that is, socialize them. If some aspect of the Grid West setup is missing or unworkable or has unintended consequences, the solution is likely to “uplift” those costs. In California, charges for “unaccounted for energy (UAE)” have exceeded the cost of the organization itself. While Grid West does not have unaccounted for energy in its Stage 1 design, it does have potential loss reallocations.

FERC Engagement or Non-engagement.

There is no assurance that FERC will be engaged when it should be or stay out when it shouldn't. An example of the form is the past agendas that FERC has strongly pushed—SMD, for example—and it may have such agendas in the future and force them on Grid West directly, if it can, or indirectly by exerting influence over Grid West ability to perform desired functions, set rates or recover costs.

Examples of the latter a FERC reluctance to correct for market imperfections. FERC seems reluctant to take a traditional regulatory role over the various RTOs that have been set up. It assumes that market competition will police market power issues, and it appears to be deferring to the various RTOs to make major decisions for their service territories. In fact, it is even willing to allow higher-than-market rates of return simply as a reward for joining an RTO.

On a more practical level, there is a strong possibility that FERC may become totally overwhelmed with the level of litigation and oversight it needs, but be unwilling to take the helm.

BPA and public agencies do not come under FERC jurisdiction (and some may consider that absence a bad thing), but, from my experience, FERC oversight of its public utilities has been particularly lax both before and after the general trend toward RTOs. Some hesitation on this issue may be allayed by the declaratory order requested by the filing utilities.

All in all, though, it does not look like FERC should be considered some sort of panacea for an RTO's or BPA's problems.

Governance and Lack of True Independence.

Grid West is being proposed with a thick book of bylaws considering appointment of "independent directors," membership types, membership relationships and rules for making major changes in the scope of the organization. These rules are important, but I come from a school of economics that believes that, in the regulatory process, those with focused economic interests will dominate against those with a diffuse but larger interest. It took the railroads about two years after the formation of the ICC to learn this lesson and to "capture" and dominate that regulatory commission for nearly 100 years. Or, as Woody Allen says, "85% of success is simply showing up" and the focused economic interests will show up. As a consequence, loads with a very diffuse interest (but who pay all the

fixed costs)—that is, us, rate payer groups and the like—will always face an uphill battle against the strong parties trying to influence Grid West actions.

Clearly, this is a major issue for industry in the Midwest, the Northeast and the PJM service areas, with a major complaint to FERC that transmission users are receiving the higher of embedded cost or market for certain charges.

Ultimately, end users will have to accept whatever costs are passed to them by Grid West; it is a monopoly, after all.

Prospects for Cost Shifts.

There are a number of decisions in the evolution of Grid West that can cause severe cost shifts among and between Northwest parties and California. Among them are the elimination of transmission segments from rates, the elimination of certain charges, the impact of the expiration of existing contracts, subsidies to generators—particularly distant ones—and transfer of responsibility for losses as discussed below.

Cost shifts should be a large concern of BPA customers.

Uneconomic Real Power Loss Provisions.

Power losses are a normal part of operations of any transmission system, and transmission providers always are working on ways to reduce losses. However, losses always exist on any power system. The cost of power losses is the cost of the power itself, so issues of power losses can exceed in value the elements of transmission costs, particularly in times of power-price runups. If power is \$250 a MWh, a 1% shift in losses would approximately equal the BPA network rate.

Losses are difficult to measure, and there is a tendency to “average them.” This averaging process, particularly between utility systems—BPA at 1.9% versus PacifiCorp at 4.6%--can have significant power-cost impacts on BPA customers.

Loss shifts can occur 1) at the end of the company rate period; 2) at the expiration or termination of any contract; and 3) at the sale of rights in the Grid West RCS markets.

Short-term time horizon.

Grid West is still in its formative stage, but one lesson emerging from the RTO experience around the country is that the markets being set up foster short-term power-cost and transmission thinking. The theory has been that financial instruments would allow users to hedge the short-term, but the reality has been a failure of adequate hedges to emerge. The result is a growing exposure to short-term power costs, and therefore more volatility in rates. To its credit, Grid West seems not to be following some of the causes of short-term thinking: in particular, LMP pricing.

Conservatism in operation -- throughput versus security.

Today, with transmission costs embedded within many power rates, utilities and other entities have an incentive to ensure that power is delivered. There is a risk that Grid West’s incentives will be only to see that the transmission system is reliable, and one way to ensure reliability is to allow less power to flow, not to take the system closer to its estimated limits. To the extent that Grid West lowers

throughput in order to foster security, it may accomplish its goals, but power deliveries may suffer, causing either unnecessary higher prices or curtailments.

Market power.

BPA is the dominant power provider on both sides of many transmission constraints in the Northwest, and BC Hydro is a dominant player, usually on one side. It will be difficult at best to obtain fair market prices with the same entity on both sides of a transaction. Thus, there is a potential for abuse that may harm some customers in the Grid West footprint. Alternatively, restricting utilities to tariff rates for the sale of power at certain constraints simply re-introduces regulated power markets, contrary to one of the purposes of establishing a transmission organization in the first place. This is a major open issue with Grid West.

Erosion or extension of rights under existing contracts.

The current Grid West configuration recognizes the importance of existing contracts. In California, there is a major dispute on how to interpret existing contracts. For existing contract owners, these differing views represent a risk to their contracts.

“Loads pay.”

The theory is that loads will pay for all costs eventually, so why not charge loads directly at the outset. The problem is that regional loads become the dumping ground for costs that could be assigned to other transmission users—generators, those moving power through the region. The separation of responsibility between

those who cause costs and those who pay has been a severe problem for the Northwest: Witness BPA's problems with WPPSS, the Corps and Bureau, the fish and wildlife programs, to cite a few examples. Moreover, in Grid West, loads can easily be outvoted, because they have only one-fifth of the voting rights.

Market Mismanagement.

The current California dispute on how the perfect hedge for existing contracts is treated shows how a transmission-service provider can cause misallocations of society resources. [The costs of providing the perfect hedge are uplifted to all customers, providing an incentive to overschedule on paths that have heavy existing-contract usage.] PJM's and Ercot's zonal pricing problems are further examples of market interference and mismanagement. Generalized, there is a risk of Grid West taking actions that actually interfere with the operation of the market place.